# PENSION MANAGEMENT OVERSIGHT COMMISSION

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## MEETING MINUTES[1]

**Meeting Date:** September 16, 2009
**Meeting Time:** 9:00 A.M.
**Meeting Place:** State House, 200 W. Washington St., Room 431
**Meeting City:** Indianapolis, Indiana
**Meeting Number:** 1

**Members Present:** Sen. Phil Boots, Chairperson; Sen. Robert Deig; Sen. Karen Tallian; Rep. David Niezgodski; Rep. Ed DeLaney; Rep. Woody Burton; Rep. Suzanne Crouch; Matthew Buczolich; Kip White; Randy Novak.

**Members Absent:** Sen. R. Michael Young; Steve Meno.

Senator Phil Boots, Chairperson, called the meeting to order at 9:05 a.m. Members and staff of the Commission introduced themselves. The Commission briefly reviewed the Legislative Council's policies governing study committees and the topics assigned to the Commission this interim.

### Public Employees' Retirement Fund (PERF) Update

Terren B. Magid, PERF Executive Director, distributed a folder (Exhibit 1) containing his presentation (Exhibit 1A) and several PERF press releases (Exhibit 1B). He reported that

[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.in.gov/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

PERF's last annual report was sent electronically to the Commission's legislator members, and he had paper copies for the Commission's laymembers.

*(A) Plan Overview*

PERF administers six separate plans: PERF; Judges; Legislators; 1977 Police and Fire; Excise Police, Gaming Agents, and Conservation Officers; and Prosecuting Attorneys. Collectively, the six plans have approximately 271,000 members and 1,200 employers. 30% of the members are retired, and 26% of the active members are vested. PERF is the 82nd largest pension plan in the United States.

The PERF retirement plan is a hybrid plan and has two parts. This is unique among public pension plans in the United States. The first part is the defined benefit or pension. The pension part provides a lifetime benefit based on a formula that multiplies a member's years of services times final average earnings times 1.1%. The pension part is funded by employer contributions, plus investment earnings on those contributions. Most members must complete at least ten years of service to be entitled to receive a pension benefit, and a pension benefit is not payable until a member becomes eligible at retirement.

The second part of the PERF retirement plan is similar to a defined contribution and is called the annuity savings account (ASA). A member's ASA is funded by a three percent employee contribution. For state employees, the state pays this contribution on an employee's behalf. About half of the local unit employers also pick up their employees' contributions. A member's ASA is invested at the member's direction; currently, there are six investment options. A member is fully vested in the member's ASA from day one, and a member may withdraw the member's ASA upon termination before retirement.

*(B) Operations Update*

Mr. Magid discussed PERF's strong operational performance and 92.5% customer satisfaction. PERF has received national recognition from the Public Pension Coordinating Council and the Government Finance Officers Association (GFOA) for excellence in its operations and funding. New customer service enhancements are under way, including a new financial system, daily valuation for ASAs, and a new employer wage and contribution system.

*(C) Financial Update*

Mr. Magid then reviewed the magnitude of the recent global financial meltdown, which left PERF with "no place to hide". In some cases, the impact of the downturn on public pension funds has been staggering, but PERF's financial performance has been stronger than most other states. PERF's total net assets declined 12.8% between August 31, 2008, and August 31, 2009. PERF's July 2009 valuation will be final in November, but PERF estimates that it remains well funded at 93.0%. A retirement plan funded in excess of 80% is considered well funded.

PERF projects that the employer contribution rate will increase in FY 2011. The exact amount of the increase depends upon final information from PERF's actuary in November. For the state, PERF estimates that the employer contribution rate will increase from 6.5% to between 7.0% and 7.25%. For political subdivisions, PERF estimates that the average employer contribution rate will increase from 7.1% to between 7.88% and 8.36%. Even with these increases, PERF's employer contribution rate remains well below the national average, which is 8.6%.

PERF has weathered the economic downturn better than most public pension funds because of the following factors:

(1) The hybrid benefit model. Other states are currently looking at implementing this model.
(2) A modest defined benefit formula.
(3) Ad hoc and modest cost of living adjustments (COLAs). Some other states have automatic or mandated COLAs of as much as 4-5% per year.
(4) Prudent resistance to unsustainable benefit increases during periods of high investment returns.

Even with these advantages, PERF has sustained some impacts as a result of the financial crisis and expects to respond with the following:

(1) Modest contribution rates increases in the future.
(2) Continued emphasis of risk management and diversification.

*(D) Commission Questions*

Senator Tallian asked about the funded status of funds that PERF administers other than PERF. Mr. Magid agreed to provide that information. He pointed out that PERF represents 92% and the legislators' plan represents 7% of the fund's total assets, so that the remaining funds aren't very big. The Judges' Fund, a pay-as-you-go fund, did experience an increase in its unfunded liabilities because of benefit improvements.

Senator Tallian then requested information about changes to PERF's net assets over the past four or five years. Page 15, Exhibit 1A, only shows last year's results. Mr. Magid responded that the three year change in PERF's net assets is slightly negative, about -2.9%, while the five year change is slightly positive, about 3.1%.

Representative DeLaney asked about the performance of the ASAs. Mr. Magid said that 82-84% of the amounts in the ASAs are invested in the guaranteed fund, which paid 6% last year and will pay 3.5% next year. The guaranteed fund's return is set annually by the PERF board of trustees and is based on the performance of the Consolidated Retirement Investment Fund (CRIF).

In response to additional questions from Representative DeLaney, Mr. Magid said that: (1) last year PERF received about $3.6 million more in contributions than the fund paid in benefits; (2) PERF has negotiated successfully to reduce its investment fees and commissions; and (3) diversification of PERF's investments and investment managers has worked during the recession.

Mr. Magid distributed a chart showing, by investment category, PERF's old and new target allocations, actual allocations, and 2009 policy ranges (Exhibit 2). Mr. Magid pointed out that states performing better than Indiana over the last year were either late to diversify out of fixed income or more mature in implementing their investment strategy. PERF has not studied what PERF's investment performance would have been if PERF had remained invested only in fixed income versus its performance as a result of diversification.

**Indiana State Teachers' Retirement Fund (TRF) Update**

Steve Russo, TRF Executive Director, distributed a folder (Exhibit 3) containing his presentation (Exhibit 3A) and a copy of a Certificate of Achievement for Excellence in Financial Reporting presented to TRF by GFOA (Exhibit 3B). He reported that TRF's last annual report was sent electronically to legislators, but paper copies are also available.

*(A) Plan Overview*

Mr. Russo discussed TRF's similarities and differences from PERF. TRF is similar to PERF in its governance, plan design, benefit eligibility requirements, and benefit formulas. TRF's differences from PERF include:

(1) TRF is a single fund, while PERF is a system of six separately managed funds; and
(2) TRF's membership is a single group of licensed public school teachers, while PERF' membership is a broad mix of occupations.

TRF has more than 162,000 members: 76,000 active, 43,000 retirees and beneficiaries, and 43,000 inactive (of which 5,000 are vested). TRF also has 360 employers. TRF is one fund with two accounts: (1) the pre-1996 account consisting of members hired before July 1, 1995 (45% of total active members/ 95% of total retirees); and (2) the 1996 account consisting of members hired after June 30, 1995 (55% of total active members/ 5% of total retirees). Each account is comprised of two sub-accounts: Defined Benefit (DB) and Annuity Savings Account (ASA).

Retirement benefits are the same for both accounts. The average FY08 retirement applicant was 60.4 years old with 30.5 years of service and an average annual compensation of $62,300. The average total TRF monthly benefit was $2,292 (replacing 44% of salary) consisting of a monthly pension benefit of $1,742 and an annuitized monthly ASA of $550. TRF members are also covered by Social Security and may also be participating in an employer provided 403(B) plan. From Summer 2008 to Summer 2009, TRF has experienced a 20% to 30% reduction in retirement applications. Other state teachers' retirement funds have experienced similar declines. Mr. Magid noted that PERF retirement applications increased this year, because of employee concerns that the retirement health benefits account would not be funded after this year.

*(B) Funding Sources*

Funding sources for TRF's pre-1996 account are: (1) the State General Fund and the Pension Stabilization Fund for the DB sub-account; and (2) a 3% employee contribution for the ASA sub-account. Funding sources for the 1996 account are: (1) actuarial based employer contributions (the rate is currently 7.0%) for the DB sub-account; and (2) a 3% employee contribution for the ASA sub-account. The employee contribution to the ASA sub-account of both accounts is most often paid by the employer. Next year the employer contribution rate for the DB sub-account of the 1996 account will increase to 7.5%. Funding required to pay benefits for the pre-1996 DB sub-account is expected to peak in 2030. The pre-1996 DB sub-account will be fully funded by 2035.

Mr. Russo distributed a chart (Exhibit 4) showing the projected balances for the Pension Stabilization Fund assuming 104% year-over-year general fund appropriations, an annual contribution of $30 million from lottery revenue, and either a 7.5% or a 4.5% investment return.

*(C) Financial Position*

TRF funding ratios for the pre-1996 account decreased from 37.7% on June 30, 2008, to 35.1% on June 30, 2009, and for the 1996 account decreased from 104.1% on June 30, 2008, to 94.2% on June 30, 2009. TRF's net assets declined by 15.9% between June 30, 2008, and June 30, 2009, but have increased 7.2% to $7.72 billion between June 30, 2009, and August 31, 2009. TRF's unfunded liabilities for the pre-1996 account increased from $9.72 billion to $10.31 billion between June 30, 2008, and June 30, 2009. The funding for the 1996 account decreased from a positive balance of $0.12 billion to a negative balance of $0.19 billion between June 30, 2008, and June 30, 2009.

TRF is considered one of the poorest funded public plans in the United States, but the pre-1996 account is, by design, not actuarially prefunded. The 1996 account is prefunded and is in good shape. The FY 2009 market turmoil has had no impact on TRF's ability to pay benefits, and TRF has a positive cash flow of $12 million. A modest increase (from 7.0% to 7.5%) in the employer contribution rate for the 1996 account will be effective July 1, 2010.

In response to a question from Senator Tallian, Mr. Russo explained that the unfunded liability is a snapshot of the fund on June 30, 2009, showing the amount TRF would be obligated to pay out if funding stopped, minus the fund's reserves.

The one year investment performance of the TRF Composite Fund as of June 30, 2009, was -16.00%. The three year investment performance of the TRF Composite Fund as of June 30, 2009, was -2.23%. Both of these results exceeded the S&P 500's performance over the same periods.

*(D) Operations Update*

TRF has consistently achieved high rates of accurate and on-time benefit payments and has been recognized as a high service/low cost fund by a global pension system benchmarking firm. TRF also received its first ever Certificate of Achievement for Excellence in Financial Reporting from GFOA.

TRF has increased member communications and outreach through:

(1) local one-on-one counseling;
(2) "Time in Career" based targeted communications; and
(3) online video seminars and retirement applications.

TRF's culture is one of continuous improvement every day.

**Consolidation of the PERF and TRF Boards of Trustees (Exhibit 5)**

Mr. Magid and Mr. Russo discussed the consolidation, as proposed by SB 535 introduced during the 2009 session, of the PERF and TRF boards and governance structures into one entity that would oversee management of seven Indiana retirement funds (six PERF funds plus TRF). All existing retirement funds would remain completely separate as required by federal and state law. Consolidation would not change each fund's assets, liabilities, or benefits.

*(A) Benefits of Consolidation*

The benefits of consolidation include cost savings from economies of scale that would lead to lower investment expenses and better investment opportunities, perhaps as much as $60.5 million. There would also be a one-time administrative cost savings of $8.9 million and annual cost savings of $1.2 million.

Another benefit of consolidation would be better customer service through the implementation of "one stop shopping" for members and employers. Consolidation would also allow for more efficient data sharing using a common and streamlined system. PERF and TRF are currently trying to capture some of these efficiencies without consolidation.

*(B) Issues with Consolidation*

A potential issue with consolidation as proposed in SB 535 is the board's makeup. SB 535 included prescriptive board membership requirements that would have limited the number of board members with relevant business experience, such as finance, institutional investment, accounting, and benefit administration.

Mr. Magid said that more board member independence is better, because the funds must be run as trusts and comply with fiduciary duties. Mr. Russo reported that he had discussed the issue with pension personnel in other states and learned that, for all trustees, education and training is crucial, especially education about a trustee's fiduciary duties and responsibilities.

*(C) Commission Questions*

Senator Tallian asked about board responsibilities beyond fund administration, management, and investment. Currently, there are none, except for the setting of the guaranteed rate. In some states, but not in Indiana, boards can establish benefit eligibility and amounts, which could lead to unsustainable cost increases.

Senator Tallian then asked where the $60.5 million in cost savings comes from. Mr. Russo said that he determined the figure based on an article that said a larger fund should have a 20 basis point improvement in investment returns. Mr. Sperlik of the Legislative Services Agency said that his research also concluded that a bigger fund provides better returns.

**Public Safety Issues (Exhibit 6)**

Tom Hanify of the Professional Firefighters Union of Indiana proposed several topics for study.

*(A) Deferred Retirement Option Plan (DROP)*

Because many cities and towns are going through the process of right-sizing their police and fire departments, allowing a member of the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) to enter the DROP on the date the member separates from service (called a DROP Back) would assist cities and towns and allow members to elect to receive a lump sum in exchange for a reduced pension benefit. Mr. Hanify asked the Commission to examine the feasibility and fiscal impact of these changes. In response to a question from Senator Deig, Mr. Hanify said that a few, but not many, people change their minds once they are in the DROP. Doug Todd, the PERF actuary, added that preparing a fiscal analysis for this proposal will be difficult.

*(B) Physical and Mental Testing Requirements for 1977 Fund Applicants*

Mr. Hanify testified that Indiana law requires the use of the Minnesota Multiphasic Personality Inventory (MMPI) as the baseline statewide mental examination for 1977 Fund applicants, although it is not the best measure. He proposed that the Commission study better screening processes and make recommendations to update the testing requirement.

*(C) Internal Revenue Service (IRS) Reports*

Mr. Hanify reported that he is working with Steve Barley of PERF to obtain more timely filing of reports with the IRS, and does not suggest this item as a study topic.

*(D) Pension Secretaries*

Mr. Hanify questioned whether local pension secretaries are still necessary. If they are, their duties should be redefined and updated.

*(E) Preference for Hiring Laid Off Police Officers and Firefighters*

Mr. Hanify suggested that the Indiana Code be amended to allow a local unit to give a hiring preference to a police officer or firefighter laid off by another local unit. He used the analogy to the existing hiring preference for individuals with military service.

*(F) 1977 Fund Cost of Living Adjustment (COLA)*

Mr. Hanify asked the Commission to amend the Indiana Code to remove the possibility of a decrease in the 1977 Fund pension benefit because of a negative COLA. He also asked that the Commission consider adding a minimum annual COLA of 0.5% or 1%. He suggested that the Commission look at a fiscal analysis of various minimum COLAs to set the minimum.

**Wage Claims**

Sean Keefer, Deputy Commissioner of the Indiana Department of Labor (Department), introduced Rick Ruble, Department Legal Counsel, who explained that the structure of the current statutes governing wage claims is confusing and treats employees differently depending upon whether they quit, or are fired or laid off. An employee who quits may file a lawsuit or a claim with the Department, while an employee who is fired or laid off must first file a claim with the Department before filing a lawsuit. The current statutes have not been amended since before World War II. While the Department is not advocating for any particular outcome, the Department urges the Commission to take an open minded look at the topic to address the fairness and clarity of the current situation for both employees and employers.

Mr. Ruble provided information that the number of wage claims filed with the Department is steadily increasing. In 2005, the Department averaged 60 wage claims per month; by 2007, the monthly average was 140. The amount of a wage claim filed with the Department typically ranges from $200 to $3,000. If a claim is over $6,000, the Department must refer the claim to the Attorney General, who contracts with private counsel to handle the claims.

Representative Burton asked whether the Department is simply looking for clarification. Mr. Ruble answered that the Department thinks it's more: Should everyone, regardless of how the person separated from employment, use the same procedure?

Senator Tallian commented that confusion does exist and agreed the issue needs to be resolved.

**Additional Suggested Study Topics**

Nancy Papas representing the Indiana State Teachers Association (ISTA) testified that ISTA had a favorable view of consolidation of the PERF and TRF boards, but an unfavorable view of taking fund members off of the board. People whose "necks are on the line" should be making decisions for the funds.

Senator Deig reported that he and Senator Kruse spoke to the Indiana retired employees group. The group thanked the General Assembly for a thirteenth check this year, but asked for both a COLA and an increased multiplier for the benefit formula.

Representative Burton spoke in favor of studying the wage claim issue.

Representative Niezgodski suggested two additional study topics:

(1) An expansion in the number of members of PERF or TRF who are able to withdraw the member's ASA after the member separates from covered employment and before the member is eligible for retirement. Senator Boots reported that PERF has already developed language to address this topic.
(2) A review of the buy-in amounts paid by judges and magistrates to transfer PERF service credit to the Judges' Retirement System.

He may have a third issue that he will discuss with Senator Boots.

Representative Crouch indicated that she is having an issue researched and may bring it to the Commission.

David Larson representing the Indiana State Employees Association (ISEA) asked the Commission to take a hard look at consolidation of the PERF and TRF boards. He is opposed to consolidation and believes that some efficiencies can be implemented without consolidation. He contends that the PERF board should look at providing better service before considering consolidation.

**Next Meeting Date**

The Commission selected Monday, September 28, 2009, at 10:30 a.m. as its next meeting date.

**Adjournment**

The Chairperson adjourned the meeting at 11:10 a.m.